TURNER
— LEGAL —

NEW ZEALAND INBOUND MIGRANTS – TAXATION ISSUES

The New Zealand Tax Landscape

Comparing New Zealand's (NZ) tax regime to other countries (apart from low or no tax countries) NZ has some positive attributes. There is no estate tax or duty or inheritance tax on death. There is no gift tax or duty on lifetime gifts, and no stamp duty on transfers of property. There is no distinct capital gains tax, although there are situations where income tax arises on gains made on certain types of property and in certain situations. The top tax rate for individuals is 33%, trustees are taxed at 33% and companies are taxed at 28%. Goods and services tax is 15%.

From a preservation of wealth perspective, the absence of any tax on death and the ability to make gifts without tax or duty provide every opportunity to NZ residents to organise their affairs to protect and/or pass on wealth to younger generations without it being overly depleted by state taxes.

In terms of NZ income tax, the income tax regime is well developed and its application can be quite complex. Set forth below are the key tax issues for inbound migrants, including some suggestions for planning for the first four years, and the tax implications once a new migrant becomes a full NZ tax resident.

New Zealand Tax Residency

NZ will ordinarily tax its residents on their worldwide income, and provide a tax credit (in many cases) for foreign income tax deducted from that income.

There are two tests for determining NZ tax residency: a physical presence test, and a permanent place of abode (PPOA) test.

The physical presence (or day count test) provides that a person will be a resident if they are physically present in NZ for 183 days or more in a 365-day period. The test is calculated according to a rolling 365-day period, not on any calendar or financial year basis.

Under the day count test a person will become non-NZ tax resident, assuming the person does not have a PPOA, by being physically absent from NZ for more than 325 days in a 365-day period.

The PPOA test is the primary test of tax residency. Under this test one considers all and any connections an individual has with NZ. Inland Revenue (IR) have released an Interpretation Statement detailing the various factors to take into account, with examples, but naturally each case must be considered on its own particular facts. The important criteria are whether a person has a place to live in NZ, where their immediate family reside, where their employment is located, their intentions, where their friends are, their interests and their investments.

On occasion, a person can be treated as dual tax resident where they are considered to be tax resident under the domestic tax laws of NZ and those of another country. For example, the individual may trigger a day count test in a foreign country yet retain a NZ PPOA, or vice versa. If NZ has a double tax agreement (DTA) with that other country, there is usually a series of tie breaker tests that will be applied to determine which country will have the primary right to tax the worldwide income, and which country will have the right to tax income sourced only in that country.

If there is no DTA, each country will seek to apply their respective tax obligations on the individual, which could be problematic. In those situations careful management of tax residency is required to achieve an optimum position.

The 48-month Transitional Residents Exemption

For new NZ residents, or returning NZ residents who have been away from NZ for a continuous period of 10 years or more, there is a 48-month transitional resident exemption available. A transitional resident will not be taxable on foreign (i.e non-NZ) sourced income during this period, unless it is employment income or income from services provided by the individual, which will be taxable in NZ to the transitional resident.

The intention of the transitional resident's exemption is to treat those individuals who qualify, as non-NZ residents for tax purposes, in relation to overseas investments and foreign sourced income.

Types of income covered by the exemption include income arising from interests subject to NZ's controlled foreign company (CFC) and foreign investment fund (FIF) regimes, which normally attribute income to an individual based on their investment in the overseas company, unit trust or similar vehicle. Also covered by the transitional resident's exemption are interests in, and income arising from, foreign debt instruments such as mortgages or term deposits in foreign currency, interests in the various types of foreign superannuation schemes and rental investment properties.

It is important to determine when NZ tax residency commences in order to identify when the transitional resident period commences, and expires. This is because during the period a person is a transitional resident:

- They can consider how best to organise their investments such that they generate tax efficient returns during the period;
- They may consider if and when to transfer their foreign investments to NZ or dispose of them at an optimal time before the expiry of the period;
- They may choose to make distributions from any foreign trusts or companies to themselves whilst a transitional resident.
- Consideration should be given to the timing of conversion of any share entitlements or bonuses from previous employment.

The transitional resident's exemption is only available to a taxpayer once in a lifetime, and it applies automatically to new NZ residents without formal application. A taxpayer may, however, elect out of the provisions, and they might consider this if for example a foreign loss would arise which would reduce the NZ tax liability on other income. However, one should always consider the position over the 48 month period and whether electing out of the exemption is beneficial.

NZ Tax residency

At the expiry of the 48-month period, the inbound migrant's overseas investments will become subject to the NZ tax regime, and are deemed to have been acquired at their market value on the date of acquiring NZ tax residency.

NZ has a comprehensive set of international tax rules applying to various types of investments:

The financial arrangement (FA) rules will apply to foreign currency bank accounts, mortgages, bonds and the like. The FA rules will tax any income derived, and potentially any accrued income. Foreign currency movements are also taxable and brought to account on a cash or accrual basis depending on the level of investment.

The NZ tax rules applying to pensions and foreign superannuation schemes have recently been simplified, and during the transitional resident exemption period migrants will be wise to consider whether to leave the scheme in place, transfer it to a NZ scheme or wind it up if possible.

Income generated from foreign properties will be taxable in NZ and despite the lack of a formal capital gains tax, there are provisions in the NZ Tax Act which tax gains made on a disposal of property in certain circumstances, and they will apply whether the property is in NZ or abroad.

NZ's FIF and CFC rules apply to interests in foreign companies, unit trusts and the like. The application can be complex and in broad terms seeks to tax the annual increase in value of the holding. There are a number of exclusions from the CFC and FIF regimes, such as investment sin certain Australian entities and an active income exemption. With any investment in a foreign company or other entity the spectre of double taxation can arise, and should be addressed to ascertain whether it can be minimised.

NZ's trust rules classify trusts in three categories, with fairly complex rules to determine tax imposed on distributions or benefits received. Inbound individuals will need to consider whether an election should be made to convert any foreign trust to a NZ complying trust: there is a 12-month period from the date of expiry of the transitional resident exemption period to make the election.

Note that there are reporting obligations for holding interests in CFC's and FIF's and for foreign trusts.

Non-tax considerations will play a large part in deciding what to do with foreign investments during the transitional exemption period. Exchange rates, fees and penalties imposed on withdrawals, access to and need for funds, and the effective return on particular investments are some examples. The key is to address the issues in sufficient time to implement any changes before the expiry of the transitional resident exemption period.

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Disclaimer:
These notes are not intended to provide an exhaustive or comprehensive statement of tax law and it should not be relied on or used as the basis for any decision or legal action. Detailed professional advice should always be sought to verify the applicability of the relevant legislation to the specific case.